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DISSERTATION PROJECT

"PEER TO PEER LENDING"

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CHAPTER I

Introduction –

Acquaintance with the concept of person to person lending

What is peer to peer lending?

Interpersonal lending is obviously a concept coeval to mankind itself. Undoubtedly, long before the conception of the notion of money, as soon as the first human beings firstly acquired belongings, they felt the need to share them with other persons who had a use for those belongings and were asking for consensus to use them. Furthermore, the lending and borrowing of material goods produced a feeling of deprivation to the lender and a moral obligation for some kind of compensation to the borrower. In the course of history, as the economic life of societies moved forward to inventing means of exchange and storing value, the notion of money was instituted and the object of the loan as well as the aforementioned obligation for compensation of «some kind» were, from that point and on, easily translated to monetary units. Of course the incentives for the borrowers remained the same then as well as nowadays : the lack of resources. On the other hand the motives of lenders stopped being exclusively emotional or humanitarian and evolved to a pursuit of profit. Lending started to accommodate the notion of investment. This pursuit of profit through lending, led to the creation of financial intermediaries and institutions, that have completely dominated all process of lending throughout the world.

The above short historical reference, leads to the perception that peer to peer lending is «a new twist on a centuries old idea»[1]. Actually, peer to peer lending or p2p lending is an abbreviation for person to person lending and the actual difference between it and the traditional interpersonal lending is the use of contemporary technology as the internet and electronic media. Peer-to-peer lending, also known as person-to-person lending, peer-to-peer investing, crowd lending and social lending, abbreviated frequently as P2P lending, is the practice of lending money to unrelated individuals, or "peers", without going through a traditional financial intermediary such as a bank or other traditional financial institution. This lending takes place online on peer-to-peer lending companies' websites using various different lending platforms and credit checking tools[2]. Thus, these sites generally are thought to have the greatest potential to revolutionize the existing financial market.

The advancement of digital technology, has allowed lending agreements between complete strangers through the use of electronic platforms owned by companies that actually perform industrial scale online financial «matchmaking». Peer to peer lending companies, pursuing to profit through a reasonable fee, match individual borrowers or companies with savers that are willing to invest money for a bit longer, and, usually disappointed by the low rates they receive from their savings trusted in banks, aiming at a better return they consider to be more satisfactory. As the banking middle man is being cut out, the borrowers the borrowers are charged with lower rates while the lenders get significantly higher rates than they would get from a bank or a traditional lender. What the electronic platform operator (p2p lending company) does is to allow investors to be enlisted into it's group of potential lenders and individuals seeking to finance their activities through borrowing as prospective borrowers.

In which countries is p2p a legal, state recognised enterprise.

Peer to peer lending is a legal operation in the U.S. although p2p lending companies have to comply with various legal rules, both federal and local in each state. Apart from the obligation of compliance with the federal laws such as the well known 1933 Securities Act, the p2p companies have to fully respect the local legislation of every individual state, referring to the prerequisites of issuing a license to operate, thing which makes it quite difficult for the companies to harmonize their operation with every local regime. Hence, even the largest and most high profile p2p companies have not managed to become operational in all fifty states.

The largest companies in the U.S. are «Lending Club» and «Prosper». Lending Club, the company that holds the world's vastest p2p loan portfolio, has not managed to establish it's operations in the states of Idaho, Iowa, Nebraska, North Dakota, Misissipi, Maine and Vermont[3], whereas «Prosper», the oldest p2p company, launched on 2006, has not yet managed to establish it's presence in North Dakota, Iowa and Vermont. Nevertheless, the two most prominent p2p lending companies in the U.S. are also the largest companies worldwide. What is trully remarkable or could be characterized as an extraordinary economic phenomenon is the rapid growth of volume of money facilitated in loans by those companies. It is notable that according to the financial data disclosed by «Lending Club» through it's official website according to which in January 2013 the total sum of money facilitated in loans by «lending Club» was calculated to 1,283,313,150$ whereas in December 2013 that sum exploded to the unprecedented height of 3,140,298,450$ [3].

In Europe most p2p companies operate in the wider area of the UK. London Based «Zopa» dominates the p2p market in the UK, while «Ratesetter» and «Funding Circle» are the rest of the big companies have issued innumerous p2p loans ranging from £5,000 to £1 million. «Thin Cats», «Funding Cats», «Folk2Folk» «Squirrl» and «Assetz Capital» complete the p2p lending scenery in the UK. These companies, most of whom have been launched after 2010 have given out loans of hundreds of millions of pounds and have started to alternate the climate of the British loan market.

Dusseldorf based «Auxmoney» in Germany allows private consumers to take out personal loans of between €1,000 and €20,000 from private investors. More than 10,000 projects, collectively valued at over €43 million, have been financed through the platform. Furthermore, «IsePankur» (iBanker) in Estonia (one of the oldest European company), «Pret d'Union» in France, «Boober», originated in the Netherlands, «Smartika» in Milan- Italy and «Comunitae» in Spain, are successful attempts of other European entrepreneurs to enter the firmament of peer to peer lending.

In China, a colloquial term for P2P lending is grey market, not to be confused with grey markets for goods or an underground economy. Offline peer-to-peer lending between family and friends is a popular practice and has been around in the country for centuries. In recent years a very large number of micro loan companies have emerged to serve the 40 million SMEs, many of which receive inadequate financing from state-owned banks, creating an entire industry that runs alongside big banks. As the Internet and ecommerce took off in the country in the 2000s, many P2P lenders sprung into existence with various target customers and business models. The most prominent among them are Creditease and SinoLending the former runs a huge offline network with branches in major Chinese cities, and the latter has links to Lending Club in the U.S. and concentrates on the online market[4].

While the U.S. currently leads the world in volume of crowdfunding transactions with a share of 72%, a sizable chunk will come from Europe, at 26%, and 2% from the rest of the world[5].

Function of a Peer to Peer lending Platform.

Peer to peer lending companies seek to develop an internet platform that facilitates the matching of investors – lenders that have available capital and pursue to manage it profitably with borrowers seeking accessible credit. The company's aim is to establish and manage a website that permits investors to register as potential lenders and individuals to register as prospective borrowers. Through a procedure that looks very similar to an on-line auction of loan requests, potential borrowers may attain full funding of their loan requests and potential lenders, on the other hand may find profitable lending opportunities by funding a loan request fully or partially or even obtaining a portfolio of numerous different partial funding of loans. The company will have to establish specific prerequisites that both candidate borrowers and lenders will have to satisfy in order to be granted the possibility to post loan requests or access them for investing on them.

Terms of use for Borrowers.

Borrowers may post loan requests with a fixed term (usually one, three or five years) and ask for their loan to be funded fully or partially, as the borrower may indicate with his request that he will accept less than full funding. Under the procedure of several p2p platforms, the borrower designates a funding deadline within the limits of which, the loan request should be able to attract the interest of prospective lenders and attain full fund of partial according to the minimum standard of funding that the borrower himself has already set. Nevertheless most companies choose to use a single fixed loan request deadline for all borrowers.

Borrowers will have to meet certain criteria in order to be allowed to post requests for loans within the internet space of the website thus making this request available for the potential lenders to examine. Potential borrowers have an obligation to disclose to the lenders, through the intervention of the company, specific information portraying their financial status. Indicatively, information that may commonly be required for disclosure on the borrowers behalf could include employment status, freehold property status, credit scores presumed according to lender's credit behavior, existing incidents of paying delays or past credit defaults, debt-to-income ratio, existing credit obligations or intention of creating such through other funds and other information that provide enough data in order for the company and the lenders to be able to categorize the lender and determine firstly whether he is thought to be creditworthy enough to be granted the loan and secondly the interest rate the loan should be charged with. Borrowers may also post information that complete their image profile towards the lenders and could possibly influence the lenders judgment, information such as the purpose of the loan, or a rudimentary business plan if the purpose of the loan is business.

However, borrowers are not allowed to disclose their identities directly to prospective lenders or post any information that would expose their identity to possible determination on behalf of the lenders.

Using the information offered by each borrower, the company must determine an individualized credit rating and a personalized interest rate for the loan. Then the credit rating and fixed interest rate will be posted by the company along with the aforementioned information regarding the status of the borrower, according to his own reports, and any other information the borrower chose to disclose and are relevant to the loan and it's purposes. The company usually determines a general maximum loan sum which cannot be exceeded by any potential borrower but it can also set personalized maximum loan sums (lower than the general maximum) according to the lender's assumed creditworthiness. Along with the above information, the company has to post – disclose it's own fees.

Terms of use for lenders.

Candidate lenders have to comply, on the other hand with a minimum sum of funding, a minimum amount of money accepted by the company. After viewing the informational posts regarding each loan request they have the possibility to decide to fund the full loan or a part of it. Actually it is a common practice between lenders to avoid fully funding a loan request as they find partial funding of smaller portions of loans a more preferable choice. Thus they manage to minimize their credit risk dispersing their capital to numerous transactions. The funded loans amortize through equal monthly payments to their maturity date, thus producing the desirable profit for the lenders.

The p2p lending principle of anonymity, operates vice versa as lenders are also prohibited from disclosing their true identities. This anonymity is accomplished and preserved through a simple tactic imposing all requests and transactions generally to be posted only under the user's (borrower's or lender's) user name the so called «screen names».

Functions of the Company.

The company in order to properly function must maintain with a bank (used as a cash depository) a segregated deposit account on behalf of the lenders. This account is used for the funding of the loans. Before offering to fund any loan, the potential lenders have the obligation to place – deposit in this account an amount that is sufficient to provide that funding and simultaneously is not bond to the funding of any other loan.

The lenders have to keep on holding this amount on deposit in the aforementioned account until either the relevant loan request manages to attract sufficient funding or the prospective borrower withdraws his request due to inefficient funding. The principal amount of each funded loan will be forwarded to the borrower by a bank not affiliated with the p2p Company. The bank that forwards the fund to the lender and the Bank were the deposits of the Company are being kept, may be different institutions. The funding bank deducts from the funds it provides to the borrower (and will pay to the Company as its transaction fee) a specified percentage of the principal amount of the loan. The amount deducted may vary with the credit rating assigned to the loan by the Company. At the time of the funding of the loan by the funding bank or shortly after it, the Company purchases the loan from the funding bank at face value, using funds of the applicable lenders on deposit in the funding account, and then issues to each such lender at par a digital Company Note representing the right to receive the each lender's share of all principal and interest payments received by the Company, from the borrower on the applicable loan, after, of course the deduction of the Company's servicing fees. The Company's Notes will only become direct obligations of the Company vis a vis the lenders only in case that it (the company) actually receives payments from the borrower on the relative loan, in which case the Company is legally obliged to attribute the amount of the borrower's payments to the lender. Accordingly, lenders assume all of the credit risk deriving from the loan and will <u>not</u> be entitled to recover any deficiency of principal or interest from the Company, if the borrower fails to repay the loan. The Company, facilitates the Borrower Loans on behalf of the lenders and in case of nonpayment, may assign the case to a competent agency or law office for collection. The Company holds a separate deposit account for the collections from all the borrower's payments at the bank that keeps it's deposits and, after deducting its servicing fee from each of the above payments it receives, then attributes the net amount to the lenders, thus paying off their Company Notes. These Notes are not listed on any securities exchange[6] and are negotiable for further transfer by the lenders only by a separate individual broker through an internet - based trading system. The Company provides no assurances as to the liquidity or value of these Notes it issues.

CHAPTER II

Legal framework regulating peer to peer lending.

Genesis

The concept of peer to peer lending, although comprising the mastering and use of digital technology, internet and computer science, various banking and financial tools, is actually, as foretold, very old and quite simple. Actually, so simple and yet so unprecedented, that it never occurred to any regulator worldwide that an attempt to forge a regulatory framework corresponding to such a challenge should include a regime imposing rules that would have to fence more than the simple civil law relationship between the lender and the borrower. As a result, at the time of the genesis of the peer to peer lending financial phenomenon, and even until today, the U.K. and U.S. regulatory authorities (since being the first states to have experience the creation and expansion of peer to peer lending in 2005 for the U.K. and in 2006 for the U.S.), have coped with it rather awkwardly. As a result, so far, even until today, there has been no state driven initiative aiming to produce a special legal framework to address the issues created by the peer to peer lending enterprises.

Securities Laws.

The supervisory and judiciary authorities, on the other hand, were obviously very anxious, waiting for the right moment to cease a chance to push the p2p lending companies to some kind of official state control. And that chance appeared in November 24, 2008 when the federal Securities and Exchange Commission (SEC) issued an "Order Instituting Cease-and-Desist Proceedings[7] Pursuant to Section 8A of the Securities Act of 1933, Making Findings, and Imposing a Cease-and-Desist Order" (SEC Order). The SEC Order found that the loan notes were securities pursuant to the federal Securities Act of 1933 (1933 Act) (15 U.S.C. § 77a et seq.), and that Prosper violated sections 5(a) and 5(c) of the 1933 Act by offering to sell and selling the loan notes without an effective registration statement[7]. Although Prosper, long before the intervention of the SE,C had strongly asserted that it's operation was only an internet meeting lounge were potential lenders and borrowers could meet and the platform only facilitated the matchmaking between the potential counterparties, the SEC insisted that the issuance of the Prosper's Platform Notes «are securities pursuant to Section 2(a)(1) of the Securities Act and under the Supreme Court's decisions in both *SEC v. W. J. Howey Co.*, 328 U.S. 293 (1946), and *Reves v. Ernst & Young, Inc.*, 494 U.S. 56 (1990)»[7]. According to the findings of *SEC v. W. J. Howey Co.*, 'for purposes of the Securities Act, an investment contract (undefined by the Act) means a contract, transaction, or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party'. Furthermore, since the term 'Invested Contract' is included by paragraph 2(1) of the Securities Act of 1933 defining "security", consequently, is automaticaly subject to the registration requirements of the Act. Pp. 328 U. S. 294-297, 328 U. S. 299. Apart from that, the peer to peer platform notes (Company Notes) are neither included in the restricted list of non-security notes as restrictively listed in the and *Reves v. Ernst & Young, Inc* ruling, nor bear a "strong family resemblance" to the aforementioned notes.

As a result of the SEC Order, came the filing of the first and only, up until today, juridical procedure relating with the existence and function of p2p lending. On November 26, 2008, Prosper and certain of its directors and officers were sued in a class action, *Hellum v. Prosper Marketplace, Inc.* Then, later on, the *Hellum* plaintiffs filed a second amended and operative complaint (SAC), on July 10, 2009.

The Hellum complaint alleged the following five causes of action: a claim for violation of (1) Corporations Code sections 25110 and 25503 that alleged Prosper offered to sell and/or sold the loan notes which were unqualified securities; (2) Corporations Code section 25504 that alleged the individual defendants materially aided Prosper in offering and selling the loan notes; (3) Corporations Code sections 25210 and 25501.5 that alleged Prosper sold securities as an uncertified broker-dealer; (4) section 12(a)(1) of the 1933 Act that alleged Prosper's sale of the loan notes was a sale of unregistered securities; and (5) section 15 of the 1933 Act that alleged the individual defendants were control persons of Prosper who could have known the loan notes were not sold or offered pursuant to an effective registration statement.

However, the court never issued a ruling on this case, and therefore, since no court decision was ever published on the 'Hellum' case, the only information on the class action filled, is the decision on '*Prosper Marketplace, INC. v. Greenwich Insurance Company',* a collateral case which was initiated due to the reluctance of Greenwich to offer to Prosper proper insurance coverage on the 'Hellum' case[8] . The class action lawsuit that was brought against Prosper and its directors back in 2008 has been settled on July 19th 2013. The terms of the settlement was $10 million paid to the plaintiffs in installments over three years. In exchange for a full release of the Claims as to all class members against all defendants, and subject to Court approval, Prosper Marketplace Inc. agreed to pay settlement consideration in the total amount of $10 million according to the following schedule: firstly a payment of $2 million was agreed to be delivered within 10 days of entry of an order by the Court granting preliminary approval of the settlement, and then three annual installments in the anniversary of the Preliminary Approval a) $2 million on the one-year anniversary of Preliminary Approval, (b) $3 million on the two-year anniversary of Preliminary Approval, and (c) $3 million on the three-year anniversary of Preliminary Approval. While this was a major financial blow to Prosper it was still received very pleasantly, as Prosper has adequate financial background to easily pay the first installment of this settlement, and it removes all the uncertainty about the suit that has been hanging over Prosper for several years. Thus the investors trading with Prosper returned to legal and financial certainty after the troubling of the turbulence produced by the legal conflict of the 'Hellum' Lawsuit.

Although the case was settled, the Order of the Securities and Exchange Commission (SEC) (that, as an enforcement proceeding in 2008, determined that the sale of loan notes to lenders through an internet platform, in combination with the p2p lending Company's undertaking to service the Borrower Loans and certain other services and information that the Operator provides to the lenders, creates an "investment contract" and entails the issuance of a "security") had already troubled Prosper and the other p2p Lending companies into commencing procedures for registration of their Notes with the SEC. Apart from that, the vast amount prosper was willing to pay in order to settle the law suit clearly showcases the eagerness of Prosper to shake off the feeling of uncertainty. As a result, for the first time, the peer to peer lending 'industry' was obliged to comply with a series of regulatory restrictions both federal and state, referring not to the contractual relationship between the lender and the borrower but the set up, function and liabilities of the p2p lending platform itself. Remarkably, the American legislator didn't 'move a finger' as it was the financial supervisory authorities who intervened by simply subjecting the internet lending foundations to preexisting rules, applicable to all traditional financial institutions. These legal developments established the applicability, upon the operation of the peer to peer lending operators, of both federal legal regimes dealing with securities (e.g. the 1933 Securities Act, the 1934 Securities Exchange Act, the 1940 Investment Company Act, the 1940 Investment Adviser Act and generally all of the legal framework that was created, within the financial and social context of Franklin Roosevelt's 'New Deal' to provide with governmental control and both legal and ethical restrictions over the financial markets after the painfull experience of the Great Recession), and state - level restriction frameworks dealing with securities (Blue Sky Law) and the proper function of financial institutions.

The Securities Act (1933).

Indisputably, the most important norm pervading the securities market and therefore the p2p platforms. Since the aforementioned intervention of the SEC lead the operation of the peer to peer lending companies within the scope of the Federal Securities Act (hereinafter FSA), the operators have to comply with the provisions imposing **mandatory registration of the p2p lending Operator Notes** with the SEC under Section 5 of FSA which 'regulates the timeline and distribution process for issuers who offer securities for sale. The actual registration process is laid out in Section 6, under which registration entails two parts. First, the issuer must submit information that will form the basis of the prospectus, to be provided to prospective investors. Second, the issuer must submit additional information that does not go into the prospectus but is accessible to the public. The SEC rules dictate the appropriate registration form, which depends on the type of issuer and the securities offered. Section 7 gives the SEC full authority to determine what information issuers must submit, but generally included are information about the issuer and the terms of the offered securities that would help investors form a reasoned opinion about the investment' [10]. The objective goal of these provisions, is to establish transparency and therefore certainty and the feeling of security for the investors, trusting that their capital will not be involved in opaque procedures that may lead to fraudulent schemes depriving them of their savings.

Another set of provisions of extreme importance is the provisions regulating the liability of the securities issuers for several categories of manipulation such as

a) registration statements that contain "an untrue statement of a material fact or omit to state a material fact required...to make the statements there in no misleading" under section 11 of the FSA. According to this section, a security buyer can suit an issuer, underwriter, or subsequent seller of a security and claim damages between the offering price and current value of the security, even if the purchase of the security took place on the secondary markets and not with the initial offering, if only he can trace the purchase back to the initial offering and is within the statute of limitations, without bearing the burden to prove causation or reliance on the misstatements or omissions. The underwriters and subsequent sellers have a "due diligence" defense, if they can prove that there were no indications or reasons to believe the statement was misleading or deficient.

b) Under Section 12(a)(2) grants to the purchaser of a security the right to suit, for rescission or damages, any person who offered or sold the security through a prospectus *or* an oral communication containing a material misstatement or omission which misled the purchaser due to his ignorance of the misstatement or omission.

c) "Control persons," or persons who "control" defendants liable under Sections 11 and 12 by owning stock or under agency principals, share jointly and severally the liability of the aforementioned defendants, under section 15 of the FSA which in practice enables defrauded purchasers to reach for collection of damages in cases of defendant's insolvency or defendant's lack of adequate financial resources to pay the amounts designated by the court decision.

d) Under Section 17(a) its prohibited to "employ any device, scheme, or artifice to defraud", "obtain money or property" by using material misstatements or omissions, or to "engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser." This provision is closely tracked by Section 10b of the Securities Exchange Act and Rule 10b-5, which is used more widely by investors suing for fraud[10].

e) A security purchaser is granted the right to suit a seller for selling a security that has not been properly registered obtain rescission with interest, or damages if the investor sold his securities for less than he purchased them under Section 5 and Section 12(a)(1) of the FSA.

f) Rule 424(b)(3) of the Securities Exchange Act of 1933, also requires all securities to be escorted by a prospectus form issued by the underwriter of the security, filed with the SEC including basic information about the security and the issuer such as the brand name under which the issuer operates it’s business, an income statement, the balance sheet dated within a period of 90 days to the date of the registration statement date, , a general description of the activities on which the issuer is engaged, the state under which the issuer is incorporated or generally operating, the location of the headquarters facility of the issuer, estimated profit from offering the securities, the proposed offering price of the security, or at least the method upon that price will be calculated, the balance sheet as dated within a period of 90 days to the date of the registration statement date e.t.c.

One of the most important achievements of the 1933 Federal Securities Act which was founded upon the philosophy of disclosure, is the fact that it led (followed by Section 4 of the 1934 Securities Exchange Act) to the foundation of the Securities Exchange Commission and entrusted it with the duty to supervise the security market in the U.S. SEC actions are the main mechanism for enforcing federal securities laws. ‘The SEC can prosecute issuers and sellers who sell unregistered securities, and under Section 20(b) can seek injunctions if the Securities Act has been violated, or if a violation is imminent. Section 8A also allows the SEC to issue orders to issuers to cease and desist from certain activities, and bar officers and directors who have violated the Securities Act's anti-fraud provisions. Additionally, the SEC can seek civil penalties under Section 20(d) if a party violated the Securities Act, an SEC rule, or a cease-and-desist order’[10]. The SEC may not bring actions on behalf of individual investors, but the Securities Act allows individual investors to bring civil actions under the aforementioned provisions of sections 11,12,15,17 e.t.c.

According to the, previously described, frame created by the provisions of the FSA, the p2p lending companies, as issuers engaged in an offering of registered securities (their platform Notes), are legally obliged to deliver to the investors a prospectus that sets forth specified information concerning both the issuer (the status of the company and the certificates of legitimate registration with the SEC) and the securities (the loan requests that should be accompanied by adequate information about the status of the borrower, without omissions or misstatements that could lead to misguidance of the purchaser of the security – the lender). Among other matters, the prospectus must to include a detailed description of the Operator (p2p lending Company) and the Platform Notes, an analysis by the Operator's management of the Operator's financial condition and its recent results of operations, specified financial information, a discussion of the applicable risk factors, certain information concerning the issuer's directors and executive officers, descriptions of any material transactions between the issuer and its directors, officers and/or affiliates, any material legal proceedings affecting the Operator and the plan for distributing the securities.

With the creation of the Federal Securities Act, the Newdealers, seeked to furnish the operation of the U.S. security market with a legal instrument that would impose strict rules against fraudulent and manipulative actions on behalf of the operators and agents of the various financial institutions and could implicate the financial institutions (mostly investment banks) by holding them jointly liable with the issuers of securities even when they (banks) would simply underwrite the securities. Thus, this brilliant legal regime, managed to «privatize» the state control over the quality and sincerity of the statements, escorting the initial offerings of securities, by loading that burden to the underwriting banks. Furthermore, the 1933 regulators seeked to provide securities transactions with a deep pocket (the big Banks) to cover for unacceptable damages and losses of unsuspicious investors acting in good faith. That goal was accomplished, since the investments banks, due to their vast capitals and assets, meet very demanding capital requirements and have the ability to cover massive losses without allowing turbulences in the operation of capital and securities markets. Thereby, the creators of the FSA achieved the establishment of a secure and safe environment for investments to flourish. The question arising, regarding the application of the FSA provisions on p2p lending companies, is whether it can maintain the feeling of security and certainty, since the 'newborn' p2p lending companies possess only fractions of the capital adequacy that big banks need to maintain, due to the fact that, in accordance with their financial nature they (banks) offer loans directly from their own capital pools. The truth is that p2p lending companies do not only fail to deliver such guaranties of capital adequacy but, up till now, seem reluctant to cope with or even admit this fundamental responsibility towards the security of the financial system and it's habitats. So the fact that there are no capital requirement rules applicable to p2p lending companies in combination with the fact that the pattern on which they operate, and does not require extensive use of their own capital to fund the loans (since the funds come from the p2p lenders), leads to an inconsistency with one of the primary targets of the Securities Act. This issue has already been strongly debated and is broadly considered to be the «Achilles Heel» of peer to peer lending.

The 1934 Securities Exchange Act.

In contrast to the Securities Act, the Securities Exchange Act (hereinafter SEA) primarily regulates transactions of securities in the secondary market - that is, sales that take place after a security is initially offered by a company (the issuer). These transactions often take place between parties other than the issuer, such as trades that retail investors execute through brokerage firms. ‘The Exchange Act operates somewhat differently from the Securities Act. The SEA is a mandatory disclosure process that compels financial institution – companies involved in the security trade to make public information relevant to prospective investment decisions. Also, the Exchange Act provides directly regulated the secondary securities markets – stock exchanges and the participants in those markets (industry associations, brokers, and issuers)’ [11]. In addition, as previously mentioned, Section 4 of the Exchange Act established the Securities and Exchange Commission (SEC).

More important, ‘under Section 13(a) of the Exchange Act, companies with registered publicly held securities and of a certain size are Exchange Act "reporting companies," meaning that they must disclose continuously by filing annual reports (10Ks), quarterly reports (10Qs), and reports when certain events occur (8Ks), per SEC rules. These periodic reports include or incorporate by reference types of information that would help investors decide whether a company's security is a good investment. Information in these reports includes information about the company's officers and directors, the company's line of business, audited financial statements, the management discussion and analysis section (in which the company's management discusses the prior year's performance and plans for the next year), and audited financial statements’[11] **.** Furthermore, under Sections 12(a) and 12(b) all securities traded on the securities exchanges must be registered with the SEC and the involved companies are compelled to disclose comprehensive information about themselves and the securities in the registration process, allowing and assisting thus, the SEC, to monitor the markets, for violation of securities laws related to various practices of the participants in the market. In addition, Section 9, 10b and Rule 10b-5 are the principal statutory weapons against market manipulation, fraud and insider trading. The application of the Securities Exchange Act upon the operation of the p2p lending companies has hedged legally the transactions generated by them, with an even more detailed and constraining framework destined to provide with certainty and security guarantying smoothness of that operation.

The 1940 Investment Company Act.

The ICA was legislated with an act of the U.S. Congress and is being enforced over the investments market by the SEC and ‘sets out the limits regarding filings, service charges, financial disclosure and fiduciary duties of open-end mutual, exchange-traded and closed-end funds. It is the document that keeps investment companies in check’[12].

Since, according to the above mentioned no 8984 / November 24, 2008 Cease and Desist Order of the SEC, the sale of loan notes to lenders through an internet platform creates an “investment contract”, and therefore p2p operator platforms should be considered as ‘‘investment companies’’, obviously the U.S. legislations regarding Investments began to apply to the p2p lending operation. In compliance to the Investment Company Act of 1940 Act (hereinafter ICA), investment Companies are obligated to register with the SEC before selling any of their securities to the public. This requirement of registration applies to the investment company itself and not to its securities, as the requirement of registration of company’s securities is covered by the content of the Securities Act. According to the definition provided by section 3 of the ICA, ‘investment company’ should be considered any person engaged in the business of investing in or holding securities and that owns “securities” having a value exceeding 40% of the value of its total assets. Regarding the p2p lending companies the value of the Borrower Loans that are being held by a p2p lending Operator obviously greatly exceeds 40% of the value of its total assets (low capital and assets possession was expounded in a previous paragraph) . Therefore, since there is no exemption relieving the p2p companies from application of the ICA according section 6, the operators should be subject to registration as an investment company and the prohibitions and rules provided by the act.

At this point though, serious implications could be pinpointed proving the application of the ICA upon the p2p lending operation to be rather problematic. Sections 17(a) of the ICA provides that ‘It shall be unlawful for any affiliated person or promoter of or principal underwriter for a registered investment company (other than a company of the character described in section 12(d)(3) (A) and (B)), or any affiliated person of such a person, promoter, or principal underwriter, acting as principal— (2) knowingly to purchase from such registered company, or from any company controlled by such registered company, any security or other property (except securities of which the seller is the issuer)’. It is necessary to mention that the banks in which the Funding, Deposits and Collections accounts are being maintained, are considered to be ‘affiliate’ persons to the p2p lending companies and therefore should not be allowed to purchase Platforms Notes – securities under section 17 of the ICA. The fact is that, on the one hand the p2p companies collaborate with several different banks and on the other hand the last period of time, banks have expressed a serious interest in purchasing Platform Notes or in general participating in the operation of p2p lending. Probably this is the reason why the last year, the total amount of loans facilitated by p2p companies has literally exploded as a huge flow of cash coming from banks has funded the p2p loans. Therefore, the restriction imposed by section 179(a) of the ICA, limits greatly and perhaps unduly the circle of potential lenders with vast available capitals, as all the affiliated banks would have to be excluded from participating as prospective lenders. Apart from that, the consideration of a p2p company as an investment company, would render applicable the provision of section 15 of the Security Act over permitted levels of aggregate indebtedness, which would make the operation of p2p companies a true hardship.

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Blue Sky Laws

Apart from registering its securities under the Securities Act, any issuer is obligated to register its securities in every state in which the securities are offered and circulated to the public provided that there is no legal exemption applicable. Blue Sky laws are the states laws that set standards for offering and selling securities and may provide for causes of action unavailable under federal law, while federal law may provide for causes of action unavailable in a particular state. Blue Sky laws' goal is to protect individuals from fraudulent or speculative investments. As State law and federal law do not correspond perfectly, the variety of provisions included in the state level securities laws has been an impediment to the establishment and expansion of the peer to peer lending operations throughout the U.S. as the dissimilarity between the applicable securities law in every state made compliance to each and every one of them simultaneously a very demanding challenge that kept companies from operating in all fifty states even until today. Let's not forget that a considerable portion of the blame for the 1929 crush fell on the shoulders of Blue Sky Laws, as in absence of federal securities legislation, fraudulent and manipulative schemes were enabled due to the unconformity between individual state securities laws.

Various Laws regulating p2p Lending

Apart from the legal framework of the securities legislation, the peer to peer lending companies have to comply with a series of other legal obligations that apply to all traditional financial institutions dealing with lending and, in summary, are the following:

Privacy Laws :

a) 'The Right to Financial Privacy Act (RFPA) (12 U.S.C. § 3401 *et seq.*) is a United States federal law that gives the customers of financial institutions the right to some level of privacy from government searches. Before the Act was passed, the United States government did not have to tell customers that it was accessing their records, and customers did not have the right to prevent such actions'[13]. This Act protects customers from illegal scrutiny of their financial records by federal agencies and determines procedural actions that supervisory authorities are obliged to follow when they investigate a customer's records trusted in the hands of a financial institution.

b) The Gramm-Leach-Bliley Act, (GLB), also known as the Financial Services Modernization Act of 1999, entered a financial privacy rule that requires financial institutions that offer consumers financial products or services like loans, financial or investment advice, or insurance – to explain their information-sharing practices concerning information collected about the consumer, meaning that proper explanations should be given to the customer about where that information is shared, how that information is used, and how that information is protected by the financial institution obligation to safeguard sensitive data.

Consumer Protection Laws :

a) Equal Credit Opportunity Act (1974).

This Act reprobated discrimination in credit transactions on grounds relating to the prior use of any provision of the Consumer Credit Protection Act on behalf of the customer, or color, sex, religion, race, marital status, age, national origin, the receipt of public assistance funds. Requires creditors to inform unsuccessful applicants in writing of the reasons credit was denied and entitles a borrower to a copy of an appraisal report, therefore regarding the peer to peer lending operation, 'requires a lender who rejects a borrower's loan application for any reason to send the borrower an "adverse action" notice that discloses specified information and (ii) imposes certain requirements that lenders must observe in reporting loan delinquencies or defaults to credit rating agencies' [14].

b) Fair and Accurate Credit Transaction Act of 2003

Offers consumers protection against identity theft, improves the accuracy of consumer reports, confers consumers greater control over the type and amount of marketing solicitations addressing them, prohibits the unnecessary use and disclosure of data included in their medical file, and establishes uniform national standards in the regulation of consumer reporting.

c) Fair Debt Collection Practices Act (1977).

Title VIII of that Act, prohibits abusive and harassing debt-collection practices. Regulates the actions of companies that receive mandates from other financial institutions to function as their debt collectors and limits certain communications with third parties imposing notice and debt validation requirements. As earlier mentioned p2p lending companies are assigned with the duty to hire collections companies or law offices to facilitate collection of delinquent loans. The FDCP Act, applies therefore to the operations of the p2p companies to.

Electronic Commerce Laws :

Obviously, p2p Companies execute all of their transactions in electronic form, without using hard copy documentation to back the transactions' existence. Therefore, a clearing system, such as the Automated Clearing House ("*ACH*") electronic network in the U.S. or the TARGET2 clearing system in the European Union[16], has to be used in order to execute borrower/lender registration agreements and process credit transactions. Consequently, peer to peer lending Companies - Operators need to comply with the federal Electronic Signatures in Global and National Commerce Act, aka the *E-Sign Act*, and similar state level laws in the U.S. and the Directive 1999/93/EC, aka Electronic Signature Directive, in the European Union. These regulations authorize the creation of legally binding and enforceable agreements utilizing electronic records and signatures and set forth certain disclosure and consent requirements.

Regarding electronic payments, since P2P Companies (as mentioned in previous paragraphs) are not fundamentally structured as banks, they must collaborate with 'eligible financial institutions (such as FDIC-insured depository institutions) to both fund the Borrower Loans and to receive payments over the ACH network' [14]. Therefore, p2p companies are obligated to respect, within their operation, the provisions of the Electronic Funds Transfer Act, which was implemented in Federal Reserve Board Regulation E and has established the rights and liabilities of consumers as well as the responsibilities of all participants in electronic funds transfer activities [17]. The EFTA and Regulation E contain 'disclosure and dispute resolution requirements and require a party that wishes to automatically debit a consumer account for a payment to obtain written authorization from the consumer for such automatic transfers'[14].

P2P lending is subjugated to many other regulatory restrictions and regulations the analysis of which would drive this project way out of it's size and depth limitations. Therefore a mere and not complete list of the legal regimes that find application upon the peer to peer lending operation, should include the existing legislation regarding usury laws, licensing regulation and procedure applicable in each state these companies operate, banking secrecy law, fair lending law, and many other.

Concluding, it is of importance to be said that for the purposes of this project, due to the reason that peer to peer lending platforms have shown the most significant development dynamics in the U.S., it was the U.S. regulatory framework that was presented under this chapter. Nevertheless, the European peer to peer platforms are subjected to similar, if not identical, legal regimes, such as the E.U. 2003/6/EC market manipulation Directive, the prospectus Directive, the Directive 2011/83/EU on Consumer Rights that were inspired by the legislative approach of the US regulatory authorities.

CHAPTER III
DANGERS FOR TRANSACTORS AND WIDER FINANCIALSTRUCTURES

Within the previous paragraphs of this text, a significant questioning has been expressed referring to the responsibilities that a P2P lending platform bears as a financial institution, even though not a traditional one, given the fact that, since the volume of P2P-facilitated loans has increased impressively, the number of transactors (lenders and borrowers), involved institutions (affiliate banks, clearing mechanisms, e.t.c.) and the total amount of cash borrowed through the P2P proceedings has reached a size and an expansion rate that could become capable of creating serious turbulences to the financial markets in the future. The global financial stereoma has been seriously disturbed by the 2008 financial crisis that followed the Lehman Brothers collapse in the U.S. and the financial markets have not yet fully overcome the consequences of this abnormality allowing the dark memories of the 1929 crush and the big recession in the to haunt the financial (and not only) authorities worldwide. In this fragile financial and business environment, all precautions should be exhausted in the pursuit of stability and certainty of financial operations that preserve the social peace and welfare. Of course, the comparison of size between a p2p lending platform and an investment bank is appeasing at the moment, but the near past has taught us that the necessary measures should be taken long before a financial institution becomes 'too big to fail'.

The SEC Cease and Desist Order No. 8984 / November 24, 2008, has been a major step to the direction of gradually regulating and providing the necessary streamline to the p2p operation field but still, has subjected p2p lending under the regulatory power of rules that have proven to be, one hand quite effective regarding financial institutions, but on the other, institutions of a completely different nature. The Securities Act along with the rest of the securities legislation have managed to set solid rules to combat fraudulent schemes and the wider notion of market manipulation, but has this regulatory framework managed to provide with guarantees of stability and protection versus a massive default phenomenon? The answer would probably be negative. Because it has not provided with a 'deep pocket' to undertake the consequences of potential breaches of the securities law framework, a capital tank to cover the losses, since, as foretold, the P2P Platforms have limited own capital deposits. Yes the fraudulent or disreputable actions are very likely to be monitored and pinpointed but if that (the exposure of the liable violators of the securities laws) happens after the damage is done, how will the damages from capital loss be satisfied? How will the restitution or compensation expenses be covered? As mentioned earlier, the Federal Deposit Insurance Corporation offers an insurance for bank accounts of maximum $250.000 against bank defaults, but, could the mere finding of the SEC Cease and Desist Order, that the P2P Platform Notes should be considered as securities, impose and obligation for the FDIC to compensate the potential losses of the lenders' savings in case of a Platform Default. On the other hand a heretic interpretation of the insurance provided by the FDIC would lead to the impression that the default of an individual borrower should grant the lender a right for compensation, since the loan was facilitated by a P2P platform and therefore a financial institution whose operation fall under the functional scope of the FDIC. Only a few lines of potential questions-to-arise can create mayhem regarding the balance over the contractual relationships created with a P2P lending agreement. Imagine thousands of people, lenders and borrowers starting to ask question and referring to courts after a large scale default incident, given the fact that there is no specialized legal framework for P2P lending enterprises and therefore there are no 'fixed answers'.

The truth is that the absence of a specialized legal framework regulating the function of the P2P Platforms is a serious deficiency of the modern legal civilization. Even the Platforms themselves have realized that and the feeling of uncertainty that it generates. For that reason, already some of the Platforms are elaborating the creation of deposit accounts funded by the earnings of the Platform to be used as insurance capital in favor of the lenders struck by borrowers defaults. That way, the platforms feel they partly promote the feeling of certainty and security that the regulatory authorities have not so far managed to satisfy. The need for further specialized regulation in the field of peer to peer lending and crowd funding in general has started being recognized by the authorities and already, some initiatives have been announced, such as the intention of the Financial Conduct Authority in the U.K. that intents to enter new regulation regarding crowdfunding enterprises that will allow the distinction between loan based and investment based crowdfunding. 'The proposals will make the crowdfunding market more accessible, will help foster competition and facilitate access to alternative finance options while also providing additional consumer protection'[18].

CHAPTER IV
THE USEFULLNES AND POSSIBILITY OF PEER TO PEER LENDING IN GREECE

The Usefulness of a study on peer to peer lending.

The worldwide financial crisis that was "detonated" by the Lehman Brothers collapse on 2008 resulted on a cash shortage throughout the capital markets further squeezing the financial liquidity of Banks. Consequently, the Banks appeared, since, reluctant to finance households and small businesses that either suffer or even perish economically due to the credit suffocation. In many countries where peer to peer lending financial operations have already been operational by the time the financial crisis erupted, these enterprises found "breeding ground" to expand and supply with funds many households and small businesses, allowing them to survive or even flourish. Thus, the peer to peer companies have become visible, though yet small, in the financial map, creating a new sector of financial services while smaller economic units constituting valuable social cells, benefited on their struggle to survival.

Meanwhile, in Greece, the concept of peer to peer lending is almost completely unknown, and not legalized or recognized, as a form of financial institution, by the official state. Nevertheless, the country is suffering by a unprecedented lack of liquidity strangling the economic activity, as businesses and households have no access to credit. Banks appear not only reluctant but virtually unable to cover the credit needs of the markets, due to their own financial problems deriving from the unofficial default of the public sector that resulted to massive losses due to government bonds haircuts, concluding to severe imbalance of their own liquidity ratios according to the relevant E.U. Legislation. The lack of cash flows combined to the "blockage" of Greek businesses and households from credit, have led to a nightmarish rise of unemployment rate and a general image of social and economic disintegration.

The absence of credit, therefore, is one of the most pressing problems that the governments of the last years have not successfully managed to deal with. As the severity of this problem becomes indisputable, it is necessary to examine every possible alternative channel that could provide the Greek market with liquidity. Of course it would be rather unrealistic for anyone to suggest that peer to peer lending operations could replace the role of the traditional banking system in financing small financial units as a small business or households, but the need to "fill in the gaps" that the shrinkage of the banking sector has left behind it and to find new alternative paths of providing the market with liquidity and thus promoting local entrepreneurship is more imperative than ever.

Therefore it would be useful to examine, as thoroughly as the nature of a dissertation project allows, the advantages and disadvantages, the risks and potential that this form of financial institution in it's infancy could offer or threaten with.

Prospect of peer to peer lending in Greece.

In the context of the suffering Greek Economy, the rate of bank loan defaults has reached unprecedented increase. By the end of 2012 the amount of the delinquent loans (household, business, personal, mortgage loans) towards Greek Banks had reached the vast amount of 66 billion euros. The conditions of recession, state tax invasion and wide financial hardship have further increased those numbers dramatically during the year 2013. Apart from the households and businesses that are unable to cope with their debt responsibilities, even healthy businesses bear unprecedented credit suffocation, due to the banks' unwillingness to finance any business activities and initiatives, even quite favorable ones, due to the diffusible fear of default. Under these circumstances, it is obvious that any alternative that would lead to financing of healthy and realizable business plan should be welcome. But a reasonable assessment of the conditions in the credit market in Greece wouldn't fail to diagnose the fact that a large portion of the defaulting loans are asset backed loans. Therefore, if even asset backed loans tend to default during the Greek recession, what are the odds that a non-asset backed loan like a peer to peer loan would be redeemed without problems or delinquencies? A raw empirical estimation would lead to the conclusion that the odds are quite minimal. Thus, without having conducted any statistical research, one would say that the chances of a peer to peer lending platform to flourish and profit in Greece in the current time is more or less a utopia.

On the other hand, humanitarian feelings of suffering people for one another along with the hope for new ideas and motives of entrepreneurship might make a difference and back the success of another form of crowdfunding.

Crowdfunding in Greece.

When traditional lenders and investors appear indifferent or simply unable to finance pioneer ideas and business plans, perhaps the anonymous crowd manages to worthily substitute them. Since 2009 when the institution of crowd funding or internet based microfinance made it's appearance, there were only four or five crowdfunding platforms globally but today, their number counts to more than four hundred and fifty.

The major difference between peer to peer lending and internet microfinance, is the fact that these platforms match not lenders and borrowers but rather sponsors – donators and beneficiaries. Crowdfunding (alternately crowd financing, equity crowdfunding, crowd equity, crowd-sourced fundraising) is the collective effort of individuals who network and pool their money, usually via the Internet, to support efforts initiated by other people or organizations. Crowdfunding is used in support of a wide variety of activities, including disaster relief, citizen journalism, support of artists by fans, political campaigns, startup company funding, motion picture promotion, free software development, inventions development, scientific research, and civic projects[19].

A group of Greek and Lithuanian Computer scientists, Lawyers and Economists, have made the first step forward, creating a world originality in the field of crowdfunding. In 2012 they kick – started, for the first time, a revolutionary form of start-up platform, that will match persons seeking to finance a new company and micro-investors that are willing to pay a small amount and in exchange receive shares of the new company, as soon as it is incorporated. This operation was only available within platforms with limited number of members . Mr Konstantinos Parissis, Lawyer and Economist, co-founder of "Startersfund.com" explains that "when company shares are given in exchange for the investment, the potential benefits multiply and the transparency that is imposed is even wider". "Stertersfund.com" was created by Konstantinos Parissis, and a computer scientist from Lithuania, with the assistance of legal advisors, economists, businessmen and business advisors from Athens, Great Britain, Cyprus and the U.S. and it's creation was funded by Greeks of the Diaspora.

Nevertheless, the operation of crowdfunding platforms is not limited to business concepts. Other platforms have created an environment aiming to assist the development of artss. The crowdfunding platform groopio.com, founded by mr. Dimitris Anagnostou, hosts crowd-sponsoring requests for the realization of theatrical shows, music albums, novels, poetry publications and even humanitarian assistance such as the construction of a water well in the village of Ulogh, Kenya.

Crowdfunding, thereafter, has the potential to offer to the Greek economy start-ups of pioneer small-scale business activities that could become the yeast of the much desired transformation of the Greek productivity model that seems to have decayed and is currently unable to fulfill the need for economic development and social welfare. It is obvious, that crowdfunding cannot cover the needs for financing the 'famous' restart of the Greek economy, but may contribute to the creation of sporadic private 'success stories' that would set the example and show the way to the rest of the productive forces of the country and provide with a significant psychological impact leading to optimistic estimations of the national financial future.

It is therefore, obvious that the existing financial and social conditions in Greece favor the successful development of crowdfunding rather than peer to peer lending. The promising element of this ascertainment, is that the development of crowdfunding in Greece is very likely to form the proper conditions for the creation and expansion of Greece – based peer to peer lending enterprises in the future, as along with the development of the legal environment that will have to follow the steps of crowdfunding, willingly or not, the Greek public will become familiar with the existence and handling of small-scale internet based financial activities and as a result the whole notion of peer to peer lending will become much more conceivable.

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